Supreme Court, U.S.
FILED
JUL 14 1995
CLERK

(3)

No. 94-1950

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

SERENE G. SHAPER,
Petitioner,
v.
ROGER W. TRACY,
Tax Commissioner of Ohio,
and
BETTY MONTGOMERY,
Attorney General of Ohio,
Respondents.

On Petition for a Writ of Certiorari to the Ohio Tenth Appellate District Court of Appeals

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

Respondents' Brief actually acknowledges the fact that the tax issue is one of utmost public importance, but argues for declining the case by pure misstatements of the law.

I. THE PUBLISHED ARTICLES REFLECT THE EXTREME IMPORTANCE OF THE ISSUE AS WELL AS THE GENERAL RECOGNITION THAT THE DISCRIMINATION CANNOT STAND.

Respondents' primary argument is that this is an issue of first impression, that the discrimination has become ingrained in law and should not be reviewed until after more cases percolate up, perhaps after a conflict develops.

As we have shown in our petition for certiorari at 15, this issue is the certain next step in a subject-area in which this Court frequently rules. The mere fact that this practice has not been challenged before certainly does not make it constitutional.

A. The Legal Scholars Long Ago Questioned the Discirmination and Found It Untenable.

This facial discrimination against commerce was long ago recognized, analyzed and concluded to be certainly invalid by the primary legal scholar in this subject area:

> . . . under a conventional commerce clause analysis, the present tax exemptions discriminate against interstate commerce and, in view of the availability of reasonable, nondiscriminatory alternatives, the discrimination cannot be justified on the ground that the statutes further a legitimate state purpose." James F. Blumstein, *Some Intersections of the Negative Commerce Clause and the New Federalism: The Case of Discriminatory State Income Tax treatment of Out-of-State Tax-Exempt Bonds,* 31 Vanderbilt Law Review 473, 564 (1978).

Just last year, Professor Blumstein revisited the issue and concluded that the discrimination fares no better under current Commerce Clause decisions:

> "The analysis in the article indicated that such discriminatory treatment of out-of-state tax-exempt income violates the Commerce Clause, as interpreted by the United States Supreme Court. Since 1978, the case law decided by the Supreme Court has strengthened that conclusion."

James F. Blumstein, *Discriminatory State Income Tax Treatment of Out-of-State Tax-Exempt Bonds,* 15 Municipal Finance Journal 53, 53-54 (1994).

B. The Financial Community's Expressed Concern.

Contrary to Respondents' assertion, the financial newspaper articles are *not* submitted to support the legal

merits of our position. The importance of the financial news media's interest in this case shows its great public importance and interest, a matter which this Court has routinely indicated as a key reason to grant writs of certiorari.[1]

C. The Actual Impact on the Market.

Respondents' disingenuous contention that uniform tax treatment of bonds (whether taxable or tax-exempt) would be detrimental to the municipal bond *market* is transparently a non sequitur. Elimination of home state-tax discrimination would make *all* municipal bonds immediately marketable nationwide, probably increasing the sales of all municipal bonds. More fundamentally, the argument that balkanizing the Republic into 50 tax duchies, each one *per force* "centering" the market(s) for municipal bonds as 50 local advantage markets is antithetical to both the purpose of the Commerce Clause[2] and the Constitution itself, whose basic view is that the Republic is one nation of people, no longer a Confederation of 50 independent States.[3]

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[1] *See Layne & Bowler Corporation v. Western Well Works*, 261 U.S. 387, 393 (1923), a patent infringement dispute, the Court held that, ". . . it is very important that we be consistent in not granting the writ of certiorari except in cases involving principles the settlement of which is of importance to the public, as disinguished from that of the parties . . ." *See also Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 79 (1955).

[2] In the antitrust field, the Court routinely points out that the Commerce Clause and the antitrust laws passed thereunder are to favor and protect competition, not competitors. *See Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962), *Brooke Group Ltd. v. Brown & Williamson Tobacco Corporation*, 113 S.Ct. 2578, 2588 (1993).

[3] *See U.S. Term Limits, Inc. v. Ray Thornton*, 115 S.Ct. 1842, 1855 (1995), a term limits case, this Court held, ". . . the Framers envisioned a uniform national system, rejecting the notion that the nation was a collection of States, and instead creating a direct

II. THERE IS NO INDEPENDENT STATE GROUND FOR AFFIRMANCE OF THE DECISION BELOW.

There is great reason for the Court to take this case since there is no sustainable state ground for affirmance. Respondents never dispute the fact that this is a pure federal constitutional issue which the State Courts cannot fairly decide. This case presents a purely federal constitutional question. In spite of Respondents' interest in obviating review by a State law based dismissal, none of the courts below could find one. If there were an independent state ground on which the decision could be sustained, the courts below would have done so. Plainly, no such independent state ground exists. Therefore, this Court should address the constitutionality of Ohio R.C. § 5747.01(A)(1) as it clearly presents a federal constitutional question.

III. THIS COURT HAS CONSISTENTLY AND ACTIVELY ELIMINATED DISCRIMINATORY STATE EFFORTS TO PROTECT LOCAL INTERESTS.

This Court has never consciously abided a discriminatory tax scheme that was enacted to protect local interests. Respondents' misdescribe *Bonaparte v. Tax Court*, 104 U.S. 592 (1881), as implicitly validating a similar legislative scheme as the one that exists in this case. Respondents' Brief at 3. *Bonaparte* did no such thing. Rather, it rejected the authority of a state bond issuer (one which exempts its own obligations) to force another state to exempt its interest payments from tax upon holders' who reside in the "recipient" state. *Id.* *Bonaparte's sole* relevance here is that a State has no special powers when it is acting for its own interests, unequivocally declaring that when a state sells in the marketplace, it has no attributes of sovereignty as to the debt it owes, that "it is compelled to go into the market

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link between the National Government and the people of the United States."

as a borrower, subject to the same disabilities . . . as individuals." *Id.* at 595.

IV. OHIO IS NOT A MARKET PARTICIPANT IN ITS TAXING BONDS, THUS NOT EXCEPTED FROM THE COMMERCE CLAUSE.

Throughout this litigation, Respondents' have repeatedly argued that Ohio is a market participant in taxing the out-of-state bonds. This is the one issue that the Court of Appeals below answered correctly, holding that Ohio is not a market participant, in its taxing the bonds.

The market participant doctrine is a limited exemption from Commerce Clause restrictions for states' actions in buying or selling goods or services as market participants, distinct from their actions as governmental market regulators. The Court of Appeals stated:

> . . . Clearly, when a state chooses to sell bonds and enter into the securities market, it is acting as a market participant. However, when a state chooses to tax its citizens, it is acting as a market regulator . . . *Shaper v. Tracy*, 97 Ohio App.3d 760, 763-64 (1994).

The Court of Appeals soundly relied on *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988), which resolutely declared that the assessment and computation of taxes is "a primeval governmental activity." *New Energy*, 486 U.S. at 277. Respondents' contention that it is a market participant in taxing bonds of other states with whom it is competing is a proposition recognized nowhere except in the Ohio State court decision below.

V. RESPONDENTS' ARGUMENT TO DUCK THIS CASE IN FAVOR OF THE SEPARATE TAX REFUND CLAIM PROCEEDINGS FOR DIFFERENT YEARS IS THE RESPONDENTS' TACTICAL EFFORT TO PREVENT ANY REVIEW AT ALL.

Respondents' statement that Petitioner is involved in a parallel tax refund action pending in the state courts

for different tax years, fails to mention that this has been the Respondents' strategic maneuver to prevent any court from deciding the issue at all.

Respondents requested that the Ohio Supreme Court decline to exercise its discretionary jurisdiction in this declaratory case appeal in order to hear the issues instead in the mandatory jurisdiction tax refund litigation. However, its pending Motion to the Ohio Supreme Court on the mandatory jurisdiction appeal now asserts that the Ohio Supreme Court is precluded from adjudicating that case under the doctrines of collateral estoppel and/or res judicata because it declined to hear this case!

Such a "shell game" theory of tax litigation is untenable. Due Process and the judicial system are not to be run as the State's carnival game, in which the litigants against the State are strategically doomed by legerdemain, in which the taxpayer is first declined under Shell No. 1 (because Shell No. 2 is preferred), but then must lose under Shell No. 2, because she was declined under Shell No. 1.

Due Process requires a means by which taxpayers can obtain redress. In *Reich v. Marcus E. Collins*, 115 S.Ct. 547 (1994), this Court expressed its exasperation and the end of its tolerance for the many State Supreme Courts' efforts to thwart refunds which are legitimately owed.[4] While due process allows a State to maintain a

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[4] Georgia, like numerous other states, had taxed retirement benefits paid to federal retirees while exempting those paid to its state retirees, prior to the decision in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989). Georgia then repealed its state retiree tax exemption, but opposed refunding federal retirees the unconstitutional taxes they had paid before the Court's 1989 decision in *Davis*. Even after *Harper v. Virginia Dept. of Taxation*, 113 S.Ct. 2510 (1993), the Georgia Supreme Court sought to thwart refunds under its own refund statute where the law under which the taxes were assessed and collected was itself subsequently declared to be invalid. It then denied Reich's petition seeking reconsideration under *McKesson Corp. v. Division of Alcoholic Beverages and*

remedial scheme that is either exclusively predeprivation, exclusively postdeprivation, or a hybrid, and may reconfigure it over time to fit changing needs, it may *not* unfairly configure the process to prevent any recovery at all. *Id.* at 548. In an extremely irate opinion, the Court condemned Georgia's bait-and-switch tactics in refusing the taxpayer's claimed refund because of a Georgia refund statute enacted after the tax was assessed and collected. Justice O'Connor, for a unanimous Court, castigated Georgia's holding out what appeared to be a clear and certain postdeprivation remedy, only to declare, *after* a taxpayer has paid the disputed taxes, that the remedy no longer existed. *Id.* at 550-51.[5]

VI. RESPONDENTS' ARGUMENT THAT THE DISCRIMINATION IS A FUNCTION OF THE OHIO CONSTITUTION, THEREFORE AFFORDED SPECIAL PROTECTION UNDER THE COMMERCE CLAUSE, IS UNTRUE AND HAS NO BASIS IN LAW.

Respondents' assertion that the source of this discrimination ought to be permitted because it arises from the

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Tobacco, Fla. Dept. of Business Regulation, 496 U.S. 18 (1990) and similar cases, which establish that due process requires a "clear and certain" remedy for taxes collected in violation of federal law, and that a State may provide that remedy before the disputed taxes are paid (predeprivation), after they are paid (postdeprivation), or both. *Id.* Reich petitioned for certiorari, and the Court remanded for further consideration in light of *Harper v. Virginia Dept. of Taxation*, which had relied on *McKesson* in circumstances similar to this case. In again denying Reich's refund claim, the Georgia Supreme Court reviewed Georgia's predeprivation remedies and found those remedies to be ample, but not available to him and again rejected his claim. The taxpayer again petitioned for certiorari.

[5] *National Private Truck Council, Inc. v. Oklahoma Tax Commission*'s elimination of § 1983 as a vehicle to challenge state tax provisions makes it difficult enough for any but the wealthiest taxpayers. —— U.S. ——, 1995 WL 360189 (U.S. Okla. June 19, 1995). The Court should not condone strategic State efforts to render it entirely impossible.

Ohio Constitution and is not solely a function of statute, has no legal basis and is not true. In fact, while the Ohio Constitution contains provisions prohibiting tax on certain types of Ohio bonds, there is no overall provision exempting all Ohio bonds from taxation. Respondents indeed cite to no Ohio Constitutional provision that excludes *all* Ohio bonds from taxation. Respondents' Brief at 2.[6] There is *no* provision in the text of the Ohio Constitution that prohibits the taxation of interest earned on all Ohio municipal bonds. Therefore, the opposite of what the Respondents assert is indeed true: this discrimination is *solely* a function of the Ohio Tax Code's statutory definition of Ohio adjusted gross income for taxation.[7]

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[6] In their Brief, Respondents' cite to seven sections of the Ohio Constitution. Analysis shows that each of these provisions excludes from taxation only the type of bond mentioned in the title of the provision, and they do not prohibit tax on Ohio general obligation bonds, in particular.

Art. VIII, § 2b	Adjusted compensation for service in World War II.
Art. VIII, § 2c	Construction of state highway system.
Art. VIII, § 2f	Authorizing bond issue to provide school classrooms, support for universities, for recreation and conservation and for state buildings.
Art. VIII, § 2g	Authorizing bond issue or other obligations for highway construction.
Art. VIII, § 2i	Capital improvement bonds.
Art. VIII, § 2k	Issuance of general obligations of the state to finance local government public infrastructure capital improvements.
Art. VIII, § 16	Financing housing for individuals and families by state and political subdivisions. Respondents' Brief at 2.

[7] R.C. § 5747.01(A)(1), the statute being challenged by the Petitioner defines:

But even if it was the Ohio Constitutional provisions that were the source of this discrimination, those provisions would be no less subject to the federal Commerce Clause or the Supremacy Clause. The Supremacy Clause provides that the Constitution and Laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land. U.S. Const., Art. VI, cl. 2. Under the Supremacy Clause, the Constitution and laws of the United States are supreme over State Constitutions and State Laws. U.S. Const., Art. VI, cl. 2. Therefore, even if the discrimination was mainly or solely a function of the Ohio Constitution, it would still be invalid. The notion that a State can preempt the federal Constitution simply by putting a provision in its own constitution is a matter that this Court would want to address in order to prevent the concept from acquiring any legitimacy at all.

VII. PETITIONER'S OUT-OF-STATE BONDS ARE IRRELEVANT TO THE ISSUES IN THIS CASE.

Petitioner's out-of-state bond holdings were never requested in this case, and have no relevance to any of the issues presented. Respondents state that the record contains only copies of Petitioner's Ohio income tax returns. In fact, this is all the record needs to contain. Because this is a declaratory judgment action, the nature of the out-of-state obligations on which tax was paid is totally irrelevant. The question here is whether the State of Ohio

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(A) "Adjusted gross income" means adjusted gross income, as defined and used in the Internal Revenue Code, adjusted as follows:

(1) Add interest or dividends on obligations or securities of any state or of any political subdivision or authority of any state, other than this state and its subdivisions and authorities; . . . Ohio R.C. § 5747.01(A)(1).

The discrimination results from the requirement in § 5747.01(A)(1) that interest on obligations or securities of any State, *other than the State of Ohio*, is included in the taxpayer's adjusted gross income.

has the right to tax the interest on out-of-state bonds while it consciously chooses not to impose tax on the interest from Ohio obligations. Clearly, the detail of Petitioner's out of state bonds has no relevance in determining the answer to this question.

In fact, in the parallel tax refund case, the Tax Commissioner acknowledged that the nature of the Petitioner's holdings had no bearing on any decision it would render. Appendix at 3a. If the Tax Commissioner acknowledged that the nature of the bonds were completely unnecessary for resolution of the tax refund case, *a fortiori,* they certainly have no relevance here, in the declaratory action.

CONCLUSION

This case presents a Commerce Clause challenge to Ohio's practice of taxing the interest on out-of-state municipal bonds while exempting the interest on its own in-state municipal bonds. The outcome of this case affects the future of the nationwide municipal bond market enormously.

Accordingly, the petition for writ of certiorari to the Ohio Appellate Court should be granted.

Respectfully submitted,

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